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Sources of Growth in Selected State and Local Government Tax Receipts

FROM 1961 to 1980, general own-source receipts of State and local governments as measured in the national income and product accounts (NIPA's) increased more than $220 billion, or six times. In this article, the analysis of this growth goes beyond the conventional analysis by type of receipt and by type of jurisdiction to examine what are called the "sources" of growth. The article distinguishes as sources of growth legislative actions, on the one hand, and events outside the reach of legislative actions—mainly economic activity and inflation—on the other.

Analysis of these sources for receipts that make up 65 to 70 percent of the total indicated two distinct periods. In 1962–72, legislative actions accounted for between one-quarter and one-half of the growth in most years. In 1972–80, economic activity and inflation accounted for virtually all of the growth. In the latter period, legislative actions held down growth in receipts of local government and there was a shift of fiscal resources away from local toward State government. The introduction of "circuit-breakers" and other initiatives, such as California's Proposition 13, in property taxes, and removal of certain items from the sales tax base, were among the specific legislative actions holding down growth in receipts in 1972–80. More generally, improvement in the State and local fiscal position, in part a result of accelerated growth in Federal grants-in-aid, lessened pressure for continued increases in tax rates and bases.

Coverage and framework

In the NIPA's, general own-source receipts consists of personal tax and nontax receipts, corporate profits tax accruals, and indirect business tax and nontax accruals. This article covers seven types of these receipts for which information on legislative actions can be found or derived (table 1). A substantial portion of the 30 to 35 percent of general own-source receipts not covered are local government receipts.

Not all State legislative actions are covered—for example, those made after 1974 to increase receipts related to exploitation of energy sources (severance taxes, rents, and royalties). However, most of the receipts changes resulting from legislative actions are reflected in the data presented.

Except in the case of property taxes, the discussion is in terms of specific legislative actions—imposition of new taxes (or abolition of old ones), rate changes, or changes in the tax base. Property taxes are discussed in terms of: (1) average effective tax rates, i.e., the tax liability as a percentage of assessed value of taxable property; (2) the relationship between assessment values and market values (assessment/market ratios); and (3) the relationship between current- and constant-dollar values of taxable property. The alternative framework is necessary because the task of estimating the effects of property tax rate actions for 80,000 local governments, most of which are empowered to levy property taxes, is too complex to attempt.

Table 1.—Selected State and Local Government Taxes as a Percent of Total General Own-Source Receipts

Year	Total general own-source receipts (billions of dollars)	Indirect business tax and nontax accruals				Personal tax and nontax receipts		All other general own-source receipts
		Local property tax	State general sales and use tax	State motor fuel tax	State alcoholic beverage and tobacco taxes	State income tax	Local income tax	
1961	48.1	29.6	11.9	8.3	4.1	5.9	0.6	30.2
1962	45.7	29.4	11.8	8.1	4.0	6.0	.7	30.2
1963	49.9	29.4	11.6	8.0	4.0	6.1	.7	30.2
1964	54.4	28.7	11.8	7.7	3.9	6.5	.9	30.6
1965	59.0	28.2	12.4	7.5	4.0	6.7	.8	30.8
1966	64.7	26.3	12.2	7.3	4.0	7.4	1.0	30.3
1967	71.0	26.9	13.4	7.1	3.9	7.5	1.4	29.8
1968	81.6	26.7	14.3	6.7	3.9	8.5	1.4	29.5
1969	91.6	26.8	14.5	6.5	3.7	9.4	1.5	29.6
1970	101.7	26.1	14.5	6.3	3.9	9.6	1.5	29.6
1971	110.9	26.7	14.6	6.0	3.7	9.6	1.5	29.9
1972	120.3	26.6	14.6	5.9	3.6	11.3	1.7	29.8
1973	141.5	24.9	14.9	5.8	3.5	11.9	1.6	30.4
1974	162.8	24.9	15.6	5.3	3.4	11.8	1.7	30.9
1975	186.3	24.2	15.5	5.0	3.2	12.0	1.7	31.4
1976	187.1	30.3	15.6	4.8	3.0	12.5	1.8	32.0
1977	208.4	29.0	15.9	4.6	2.8	13.0	1.8	33.4
1978	226.0	27.4	16.6	4.3	2.7	14.0	1.7	33.3
1979	242.6	25.6	17.2	4.0	2.5	14.8	1.7	34.7
1980	264.5	24.6	17.3	3.6	2.4	15.3	1.6	35.2

Local indirect business property tax accruals

Although local indirect business property tax accruals grew substantially from 1961, they grew less rapidly than did general own-source receipts as a whole; they remained, however, the largest single own-source receipt for States and localities. These taxes are levied as a proportion of the value of real property—structures (including residences) and the land upon which the structures rest—and business personalty—equipment, vehicles owned by business, in-

ventories, and the like. Some localities levy property taxes on intangible property—bank stock, for example—but this represents a negligible proportion of the tax base. (Property taxes on household furnishings are included in personal property taxes in the NIPA's.)

Table 2 shows property tax accruals calculated on several different bases in order to isolate the sources of growth. Column 1 is the regularly published accruals estimate (see NIPA table 3.3). Column 2 shows what these taxes would have been if the average effective tax rate had been held constant at the 1961 level. Column 3 is the difference between columns 1 and 2, and is the accruals due to the changes in the average effective tax rate from the 1961 level.

Column 4 shows what property taxes would have been if the assessment/market ratio had been held constant at the 1961 level, and column 5, the difference between column 4 and the published accruals in column 1, is the accruals due to changes in the assessment/market ratio from the 1961 level. Column 6 holds both the average effective tax rate and the assessment/market ratio constant. Column 7 again holds the average effective tax rate and assessment/market ratio constant, but applies them to market values calculated in 1961 dollars to remove the effect of inflation.[1] Column 8 is the difference between columns 6 and 7, and is the accruals due to the rise in prices of taxable property.

Table 3 shows the annual change in property taxes calculated on the various bases shown in table 2. Columns 1, 2, and 3 present total changes in the published accruals, changes due to real growth in the taxable property, and changes due to inflation, respectively. Columns 2 and 3 are changes that are not the result of legislative actions. Columns 4 and 5 show changes due to changes in the average effective tax rate, and due to changes in the assessment/market ratio.

The contribution of real growth in taxable property varied considerably. Only once from 1962 to 1969 did real growth generate more than $0.4 billion in tax increases. The weak increases in 1968 and 1969, after a strong 1967 increase, may be related to the urban unrest prevalent in the later 1960's, when much inner-city property was abandoned by owners and thus effectively removed from taxable status. In 1970–76, the tax increases generated by real growth averaged about $1.2 billion. The small increase in 1977 probably reflects reduced additions of new structures to the tax base during the 1974–1975 recession.

Table 2.—Local Government Indirect Business Property Tax Accruals, Various Measures

[Billions of dollars]

Year	Published	Assuming 1961 effective tax rate	Column (1) less column (2)	Assuming 1961 assessment/market ratio	Column (1) less column (4)	Assuming 1961 effective tax rate and 1961 assessment/market ratio	Assuming the application of 1961 effective tax rate and 1961 assessment/market ratio to market values calculated in 1961 dollars	Column (6) less column (7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1961	17.0	17.0	0	17.0	0	17.0	17.0	0
1962	18.4	17.5	.9	18.4	0	17.5	17.4	.0
1963	19.7	17.9	1.8	19.6	0	17.9	17.7	.2
1964	21.1	18.3	2.7	21.0	0	18.3	18.0	.3
1965	22.5	18.8	3.7	22.5	0	18.7	18.2	.6
1966	23.8	19.2	4.6	23.6	.1	19.2	18.2	1.0
1967	26.2	21.5	4.7	26.1	.2	21.4	19.4	2.0
1968	29.1	24.1	5.0	28.3	.8	23.4	19.5	3.9
1969	31.9	26.8	5.1	30.6	1.3	25.5	20.0	5.7
1970	35.7	30.2	5.5	34.4	1.3	28.9	21.5	7.4
1971	39.5	33.8	5.7	38.3	1.1	32.7	23.2	9.5
1972	42.2	37.2	4.9	41.3	.8	36.4	24.5	11.9
1973	45.2	41.0	4.2	46.2	−1.1	42.1	25.5	16.5
1974	47.9	46.1	1.8	49.3	−1.5	47.5	26.0	21.6
1975	51.9	51.7	.2	53.8	−1.9	53.6	27.2	26.3
1976	56.7	58.0	−1.2	57.9	−1.2	59.1	28.0	31.1
1977	61.7	63.9	−2.2	62.4	−.7	65.6	28.2	37.3
1978	61.9	70.6	−8.8	66.1	−4.3	74.3	28.0	45.9
1979	62.1	79.0	−17.0	69.2	−7.1	86.2	30.0	56.2
1980	65.9	87.6	−21.7	74.6	−8.7	96.3	30.8	65.6

NOTE.—Interactions between rate and assessment/market ratio changes were separately calculated and allocated to columns 2 and 4.

Table 3.—Annual Change in Local Government Indirect Business Property Tax Accruals, by Source of Change

[Billions of dollars]

Year	Published	Annual change due to			
		Real growth in taxable property	Inflation in the value of taxable property	Change in average effective tax rate	Change in assessment/market ratio
	(1)	(2)	(3)	(4)	(5)
1962	1.4	0.4	0	0.9	0
1963	1.3	.3	.1	.8	0
1964	1.4	.3	.2	1.0	0
1965	1.5	.3	.2	1.0	0
1966	1.3	.1	.4	.8	0
1967	2.4	1.1	1.0	.1	.1
1968	2.9	.1	1.9	.3	.6
1969	2.8	.4	1.8	.1	.5
1970	3.8	1.6	1.7	.5	0
1971	3.7	1.5	2.0	.2	−.3
1972	2.7	1.2	2.5	−.8	−.2
1973	3.0	1.0	4.7	−.8	−1.9
1974	2.7	.4	5.1	−2.4	−.4
1975	4.1	1.3	4.8	−1.6	−.4
1976	4.8	.8	4.8	−1.5	.7
1977	5.0	.6	6.2	−.9	−.5
1978	.1	.8	8.6	−6.6	−2.8
1979	.2	1.0	16.3	−8.2	−2.8
1980	3.8	.8	9.4	−4.8	−1.5

1. Current- and constant-dollar estimates for taxable types of equipment and structures for fixed private capital were taken from Bureau of Economic Analysis *Fixed Reproducible Tangible Wealth in the United States, 1925–79* (Washington, D.C.: U.S. Government Printing Office, March 1982) and from unpublished BEA data.

Only in 1962–66 did changes in the average effective rate add substantially to property tax increases. In that period, tax increases generated by increasing effective rates averaged about $1.0 billion. In 1967–71, increases averaged only $0.2 billion and in 1972–80, the average effective tax rate declined so that the contribution of effective rate changes was negative, ranging between −$0.8 billion and −$8.2 billion.

Declines in effective rates did not necessarily involve explicit "millage" changes; legislative actions granting exemptions or imposing income-related ceilings on property taxes for the elderly, the poor, or other specified classes of property owners also reduce average effective tax rates. It may be that declines in tax rates brought about by these "circuit-breaker" mechanisms were partly offset by increased rates for taxpayers not qualifying for circuit-breakers.

The negative changes due to the average effective tax rate after 1971 coincide reasonably well with the major "circuit-breaker" actions taken by a number of State legislatures. The Advisory Commission on Intergovernmental Relations (ACIR) lists 30 States and the District of Columbia as having circuit-breaker programs in 1978; of these, 18 were put into effect between 1971 and 1974. Of the six in existence before 1971, four were expanded in that year.[2] ACIR estimates that these circuit-breakers lowered taxes about $0.9 billion in 1977. However, other factors, including rate freezes (such as those that became law in California in 1972 and in Indiana in 1974), also contributed significantly to the negative impact of the average effective tax rate on property tax growth. California's Proposition 13 accounted for a portion of the large 1978 and 1979 changes (about $1.5 billion and $3.5 billion, respectively), but the effect of other rate reductions in those years was significant—about $4.5 billion in 1978. It appears, therefore, that policy decisions since 1971, at least with respect to average effective tax rates, reduced property taxes markedly below levels that would otherwise have been reached.

2. "Significant Features of Fiscal Federalism, 1978–79", Advisory Commission on Intergovernmental Relations, May 1979.

Table 3 indicates that changes in assessment/market ratios had little effect on property tax growth in 1962–67, and added modestly in 1968–69. After 1970, the impact of such changes was negative. Although partly the result of legislative action, (e.g., in Maryland in 1978), most of the negative impact probably was caused by the inability of assessors to keep pace with the effects of inflation on market values. About one-half of the $2.6 billion decline in 1978 was the result of California's Proposition 13, which abruptly pushed back assessments to levels that had obtained in 1977, and in some cases, even earlier.

Changes in assessment/market ratios may reflect policy decisions primarily intended to affect property tax receipts, but they also may reflect policy decisions where there is no intent to affect the level of receipts. Where assessments have increased more slowly than market values because of a shortage of assessors, a decision might be made to hire more assessors to bring assessments up to date in order to equalize assessments, and thus tax liabilities, for properties of equal market values. In another situation, a decision might be made to alter the shares of taxes paid by different classes of property owners. For example, residential property might be assigned a lower assessment/market ratio than commercial or industrial property, thus shifting the property tax burden away from homeowners.

Sales taxes

This section discusses the growth of four major State sales taxes: general sales, motor fuel, alcohol, and tobacco products. For these taxes the effects of legislative actions were identified directly, most often with data from State revenue offices. (Local governments also have sales taxes, and they increased markedly over the period, but they are among the local taxes for which data on legislative actions are not generally available.) Administrative changes, such as acceleration of collections from businesses, are not covered because sales taxes are measured on an accrual basis in the NIPA's.

State general sales taxes.—The contribution of legislative actions to growth in this group of taxes shifted rather abruptly in 1972 (table 4). Through the 1960's and early 1970's, legislative actions accounted for between 20 percent and 70 percent of growth. In 1973–77, legislative actions still added to growth, but were much less important, contributing between 4 percent and 13 percent of growth. In 1978–80, the impact of legislative actions was negative. Base changes—primarily the removal of grocery food sales, drugs, industrial and agricultural equipment, and most recently, resi-

Table 4.—Annual Change in Selected State Government Sales Tax Accruals and Percent Due to Legislative Actions

[Billions of dollars]

Year	Total		General sales tax accruals		Motor fuel sales tax accruals		Alcohol and tobacco sales tax accruals	
	Annual change	Percent due to legislative actions	Annual change	Percent due to legislative actions	Annual change	Percent due to legislative actions	Annual change	Percent due to legislative actions
1962	0.9	41	0.5	45	0.2	41	0.1	22
1963	.7	29	.4	25	.2	14	.1	56
1964	1.0	28	.7	25	.2	16	.1	69
1965	1.4	36	.9	31	.3	18	.2	69
1966	1.7	39	1.2	44	.3	0	.2	57
1967	1.4	60	.9	68	.3	20	.2	73
1968	2.1	48	2.2	50	.5	25	.5	60
1969	2.3	42	1.6	44	.5	27	.2	84
1970	2.4	38	1.5	37	.4	28	.5	50
1971	2.6	29	1.8	26	.5	28	.3	58
1972	3.5	30	2.3	19	.6	37	.5	68
1973	3.2	19	2.2	12	.7	36	.3	33
1974	2.9	15	2.8	13	−.1	(*)	.2	12
1975	2.3	13	1.9	8	.3	38	.2	86
1976	4.3	13	3.5	12	.5	18	.2	24
1977	4.3	6	3.8	4	.4	15	.2	59
1978	5.0	1	4.4	(@)	.4	17	.2	32
1979	4.3	(@)	4.3	(@)	0	(*)	.1	11
1980	4.1	(@)	4.1	(@)	−.2	(*)	.3	8

@Effect of legislative action negative.
*Total change negative, legislative action positive.

dential utilities sales, from the tax base—were responsible for this negative turn. Rate reductions were a negligible factor. On the basis of information available for 1981, it would appear that this movement has been reversed.

State motor fuel sales taxes.—In 1961–67, legislative actions accounted for about 20 percent of the $0.8 billion average increase in motor fuel sales taxes. In 1968–73, when increases averaged twice as much, legislative actions accounted for about 80 percent. These taxes declined in 1974, as a result of the 1973 embargo by the Organization of Petroleum Exporting Countries (OPEC) on oil exported to the United States; legislated rate increases were insufficient to reverse the effects of a decline in motor fuel consumption.

Consumption increased slightly in 1975, as did taxes. Consumption continued to increase in 1976–78, at rates similar to those recorded in the 1960's; legislative actions contributed only modestly to the accompanying acceleration in taxes. In 1979–80, the second round of OPEC actions reduced consumption more severely than did the 1973 embargo. Again, legislated rate increases partly counteracted the decline.

In most States, motor fuel taxes are reserved for the use of transportation or highway departments. In addition, other departments of State government are affected by factors, e.g. the state of the economy, in different ways than are highway operations. Thus, pressures for legislative actions with respect to fuel taxes do not necessarily occur at the same time or for the same reasons as they do with respect to income or general sales taxes. Prices of goods and services purchased for the construction, repair, and maintenance of highways increased more rapidly through most of the 1970's than most other prices paid by State governments. These factors, coupled with the depressed motor fuel tax collections, have generated great pressure for legislative actions. Partial data indicate that 26 States increased motor fuel tax rates in 1981, adding $0.6 billion to accruals. Despite these rate increases, motor fuel taxes declined slightly.

Table 5.—Annual Change in State and Local Government Personal Income Taxes and Percent Due to Legislative Action

[Billions of dollars]

Year	Total		State		Local	
	Annual change	Percent due to legislative actions	Annual change	Percent due to legislative actions	Annual change	Percent due to legislative actions
1962	0.4	17	0.3	21	0.1	0
1963	.3	47	.2	50	0	0
1964	.5	14	.5	17	.1	0
1965	.4	7	.4	8	0	0
1966	1.0	24	.8	13	.2	79
1967	.9	51	.6	28	.3	97
1968	1.8	19	1.6	20	.2	13
1969	1.9	18	1.7	20	.2	7
1970	1.1	32	1.0	38	.2	(@)
1971	1.6	26	1.4	18	.2	85
1972	4.8	20	4.3	19	.5	23
1973	1.7	(@)	1.6	(@)	.1	(@)
1974	1.5	(@)	1.2	(@)	.3	0
1975	2.2	13	1.9	15	.3	7
1976	3.9	11	3.5	6	.2	50
1977	4.1	8	3.7	7	.4	23
1978	4.7	(@)	4.4	(@)	.2	8
1979	3.3	(@)	3.0	(@)	.2	0
1980	5.2	(@)	5.0	(@)	.2	0

@ Effect of legislative action negative.

State alcohol and tobacco taxes.—In all but one year from 1962 to 1972, legislative actions generated at least one-half of total receipts growth for these two taxes. In all but one year after 1972, legislative actions generated less than one-half of the total growth. Because tobacco and alcohol are regarded as "luxuries," these two taxes have traditionally been regarded as relatively easy taxes to increase. After 1972, however, State legislatures did not look to these taxes for additional revenue growth.

Thus, in each of these four major State sales taxes, legislative actions were a major contributor to tax growth before 1973, and, with the exception of motor fuel taxes after 1978, their role was smaller thereafter. There were substantial increases legislated in some States but reductions in other States were relatively more important, and increases less important, than before. This shift approximately coincided with the beginning of improvements in the fiscal position of State and local governments, partly the result of accelerated growth in Federal grants-in-aid beginning in 1972. One consequence of the improvement was reduced pressure on State legislatures for continued increases in tax rates or bases for these sales taxes. Whether or not they could have continued to bear repeated increases is open to question.

Personal income taxes

The contribution of legislative actions to personal income tax growth at the State level appears to have been more modest than for sales taxes (table 5). Legislative actions made their largest positive contribution in 1970–72, when they accounted for one-quarter of total growth. A number of States changed income tax laws during that period, but most of the increases came from six major industrial States. Illinois, Pennsylvania, and Ohio each imposed a broad-based personal income tax for the first time; Michigan and Massachusetts increased rates significantly; and New York imposed a surtax.

A large part of the non-legislated change in 1972 was caused by a change in Federal withholding practices under the Revenue Act of 1971. Because most taxpayers do not differentiate between Federal and State reporting for withholding purposes (for example, by claiming different numbers of exemptions for the two levels of government), the effect of the Federal change, which generated large increases in overwithholding at the Federal level, had the same effect at the State level. It is estimated that overwithholding added approximately $1 billion to State income tax collections in 1972. Further, because the

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withholding change was a permanent one, overwithholding as a proportion of total collections continues to be larger than it was before 1972.

The imposition of mandatory withholding, as well as other actions intended to increase the operational efficiency of a tax, has been treated as an administrative change. Such actions nonetheless can have a visible effect on the growth of a tax; a withholding system results in more tax dollars than a system that requires only annual filing. Some of the increases recorded in 1966–69 were the result of imposition of mandatory withholding in States (notably California) where income taxes were previously paid at filing or where withholding was optional.

Information about legislative actions affecting local income taxes are not readily available, especially before 1970, and therefore the percent due to legislative actions shown in table 5 are not comprehensive. Among the major identifiable actions in the mid-1960's were the imposition of income taxes in New York City, Baltimore, and in a number of Maryland counties. Much of the 1971–72 increase involved further actions in New York City, and the major 1977 legislative increase was in Philadelphia.

Table 6.—Change in Selected State and Local Government Tax Receipts

Year	Change in selected taxes (billions of dollars)		Change due to legislative actions as a percentage of total change
	Total	Due to legislative actions	
1962	2.6	1.4	52
1963	2.2	1.2	52
1964	3.0	1.3	45
1965	3.3	1.6	47
1966	4.0	1.8	44
1967	4.6	1.5	32
1968	7.7	2.7	35
1969	7.1	2.0	28
1970	7.4	1.8	25
1971	7.9	1.2	15
1972	11.0	1.1	10
1973	7.2	−2.0	(*)
1974	7.1	−2.6	(*)
1975	8.5	−1.3	(*)
1976	18.0	.3	2
1977	13.4	−.6	(*)
1978	9.8	−9.0	(*)
1979	7.9	−13.3	(*)
1980	14.1	−7.2	(*)

*Effects of legislative action negative.

Summary

Table 6 shows total annual changes for the seven types of taxes discussed, and the part due to legislative actions (including, for this purpose, changes in assessment/market ratios for property taxes). Legislative actions accounted for a substantial part—between 24 percent and 52 percent—of receipts growth in most years from 1962 to 1972. After 1972, legislative actions held down receipts growth in 7 of the 8 years. (It seems likely—on the basis of data now available, largely relating to sales and personal income taxes—that legislative actions in 1981 added slightly to the increase in receipts.) Conversely, while economic activity and inflation accounted for more than one-half of growth in these taxes in 1962–72, they accounted for virtually all such growth after 1972.

Moreover, the negative effects of legislative actions after 1972 appeared largely in receipts of local governments, specifically in property taxes. At the State level, the net effect of legislative actions, although small, was generally positive. Growth in State receipts due to increases in economic activity and to inflation occurred without the countering effects of legislative actions, such as occurred in local receipts. The result was a shift in fiscal resources toward State governments and away from localities.

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PLAM's monthly payments start at only $239, 60 percent lower than payments for the SFPM, and, assuming an inflation rate of 10 percent, remain lower through the first 10 years of the loan. (A GPM–III, in contrast, would carry initial monthly payments of $461, 22 percent lower than the SFPM's and almost double the PLAM's.) If mortgage lenders use a 25-percent payment-to-income rule, an SFPM borrower would need an income of $28,400 to qualify for a $50,000 mortgage, while a PLAM borrower would need an income of only $11,500.

There are two clear drawbacks to the PLAM from the borrower's point of view. First, of course, is the danger that income will not keep pace with inflation and that, as a result, payments as a percentage of income will rise, perhaps to an onerous level. Second, equity accumulates much more slowly with a PLAM than with a SFPM. If house prices rise 10 percent per year, for example, the SFPM borrower in table 16 will have $114,467 of equity in the house after 10 years, but the PLAM borrower will have equity of only $59,937. (Of course, the PLAM borrower will have made smaller outlays—monthly payments totaling $45,600—than the SFPM borrower—monthly payments totaling $71,000.)

From the lender's point of view, the chief advantages of a PLAM are the elimination of interest rate risk and certainty about the real value of payments. The biggest disadvantage is the reduced cash flow associated with PLAM's in their early years, which, as with SAM's, would make it difficult for lenders profitably to offer competitive rates on deposits. Also, PLAM's would probably entail the same kind of tax problems that are associated with negative amortization under GPM's.